

REPORT DOCUMENTATION PAGE			Form Approved OMB No. 0704-0188	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188), Washington, DC 20503.				
1. AGENCY USE ONLY (Leave blank)		2. REPORT DATE 11 September 1998		3. REPORT TYPE AND DATES COVERED
4. TITLE AND SUBTITLE RED ARMY INC. AN ANALYSIS OF THE MILITARY-BUSINESS COMPLEX OF THE PEOPLE'S LIBERATION ARMY				5. FUNDING NUMBERS
6. AUTHOR(S) WESTMOND C. ANDREWS				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) COLUMBIA UNIVERSITY				8. PERFORMING ORGANIZATION REPORT NUMBER 98-008 MAJOR REPORT
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES) THE DEPARTMENT OF THE AIR FORCE AFIT/CIA, BLDG 125 2950 P STREET WPAFB OH 45433				10. SPONSORING/MONITORING AGENCY REPORT NUMBER
11. SUPPLEMENTARY NOTES				
12a. DISTRIBUTION AVAILABILITY STATEMENT Unlimited distribution In Accordance With 35-205/AFIT Sup 1				12b. DISTRIBUTION CODE
13. ABSTRACT (Maximum 200 words)				
<div data-bbox="453 1340 919 1474" data-label="Image"> </div> <div data-bbox="925 1461 1321 1585" data-label="Text"> <p>DTIC QUALITY INSPECTED 1</p> </div>				
14. SUBJECT TERMS				15. NUMBER OF PAGES 15
				16. PRICE CODE
17. SECURITY CLASSIFICATION OF REPORT		18. SECURITY CLASSIFICATION OF THIS PAGE		19. SECURITY CLASSIFICATION OF ABSTRACT
				20. LIMITATION OF ABSTRACT

Red Army Inc.

An Analysis of the Military-Business Complex of the People's Liberation Army

Tuesday, April 21, 1998
Chinese Economics Course Paper

19980915 028


School of International Affairs
Professor: Carl Riskin
Student: Wesmond C. Andrews


Table of Contents

I.	Introduction	1
II.	Historical Background	2
III.	The Defense and Military Industries	3
IV.	The Structure & Management of the Military's Business Complex	5
V.	Corporatization of the Military's Enterprises	7
	A. National-level Entities	7
	B. Regional & Provincial-level Entities	9
	C. Unit-level Entities	10
VI.	Military-Business Operations, Profits, and Benefits	10
VII.	Negative Impacts of PLA Business Involvement	12
VIII.	Conclusion	14

Introduction

The decade-plus expansion of the People's Liberation Army (PLA) into both domestic and international markets has created a number of potential benefits and a variety of problems for the future of China's political, military, and economic establishments. The Central Military Commission's (CMC) adoption of the "one military, two systems" concept in the late 1980's¹, spurred PLA military and administrative units at every echelon to become heavily involved in business.² Although according to Deng Xiaoping, "Army construction should follow the overall constructive plan of the country"³; allowing the military to expand its industrial and support activities into the commercial market, while stimulating economic development, has facilitated increased corruption, smuggling, and profiteering within the PLA ranks.

Furthermore, the increased independence provided for by the military's commercial success (profits of the Chinese Military Industrial Complex is estimated to have been about 10-15 percent of the total defense budget in 1992⁴) also has potential implications for facilitating the reintegration of the military into the political process and undermining the PLA's professional development. The Chinese Communist Party's (CPC) ability to maintain stability relies heavily upon both the military infrastructure and the CPC's ability to provide sustained economic development. Many within China are concerned that an institutional separation (created by economic independence) between the Party, army, and state will create an entirely new and unpredictable dynamic at the center.

¹ The "one military, two systems" concept (i.e., creation of a two-track system in the PLA that would separate normal defense functions from the military's "public side" that produces economic benefits) was apparently first proposed by scholar Chen Fang of the Academy of Military Science in a 1988 article in *Junshi jingji yanjiu* (Military Economic Research), reprinted in translation in *Inside China Mainland*, vol. 15, no.5, pp.69-73 (May 1993). Its purpose was to create some kind of regulatory device that would head off eroding military performance and growing corruption as making money took priority in many military units.

² Mel Gurtov and Byong-Moo Hwang, China's Security: New Roles of the Military, Lynne Rienner Publishers, 1998, p.187.

³ Min Chen, "Market Competition and the Management of PLA Companies," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.207.

⁴ Feng-Cheng & Chi-Keung Li, "An Economic Analysis," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.54.

Historical Background

The PLA's involvement in economic activities can be traced back to its origins (starting with the Jiangxi Soviet in the early 1900's) as a guerrilla army, whereby military units in the field relied on their ability to remain self-sufficient by growing food to meet basic subsistence requirements. Following the establishment of the People's Republic of China (PRC) in 1949, the PLA devoted less of its efforts towards providing for its subsistence and more on training to become a professional army. Despite its modernization, the PLA has traditionally maintained this role of assisting in the country's economic construction.⁵

Since the founding of the PRC, the Chinese government has invested heavily in the development of its defense industries in terms of capital, technology, and equipment. The responsibility for managing these state-run industries, however, has remained mainly with the State Council, which continues to dominate both defense and civilian industries. Although the PLA has maintained a close relationship with many of China's industries, it has participated directly in the management of very few. The areas managed by the military traditionally have been restricted to agricultural areas, with the change in this dynamic (the PLA entering into large-scale involvement in business activities) only occurring within the past decade.

Additional factors, which helped foster the military's involvement in business activities had much to do with the downsizing of the military⁶, which began under Deng's reform plan. The combined downsizing, marked decrease in defense budget throughout the 1980's, and Deng's directive to the PLA in Beijing at the Enlarged Conference of the CMC held from 23 May to 6 June 1985⁷ (that the PLA should diversify their sources in

⁵ Tai Ming Cheung, "The Chinese Army's New Marching Orders: Winning on the Economic Battlefield," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.182.

⁶ Between 1985 and 1987 approximately 1 million service personnel were demobilized. Further rounds of demobilizations in 1989, 1992 and 1994 reduced the number of soldiers-under-arms to about 2.93 million.

⁷David Shambaugh, "China's Military Transition: Politics, Professionalism, Procurement and Power Projection," China Quarterly No. 146, Oxford University Press June 1996, p.279.

lieu of the declining budget) triggered the substantial growth within the military-business complex.

The Defense and Military Industries

In the Post Great Leap Forward period, the PLA Defense Science and Technology Commission (NDSTC) and the State Council National Defense Industry Office (NDIO) combined to set up a joint system of Research and Development, with managerial responsibilities spread among several machine building industries. This initial machine-building industry (MBI) structure survived until the end of the Cultural Revolution in the late 1970's. Today, the formerly secretive MBIs have evolved into an array of civilian-run and military-profit-seeking enterprises, which now fall under the Chinese Military Industrial Complex (CMIC), which formally emerged in 1982 with the integration of NDSTC, NDIO and the Science and Technology Equipment Commission of the Central Military Commission (SETECO).⁸

Within this bifurcated CMIC array of corporations and enterprises, it is essential to distinguish between the newly-formed, PLA-run industries, which fall under the jurisdiction of the CMC and the much larger historically, plan-based, defense-production establishment, which falls under the auspices of the State Council.⁹ Business activities falling under both the State Council¹⁰ (the defense industries) and the PLA (military industries or military-business complex) increasingly seek to diversify and "corporateize" their activities, and continue to wrangle with conflicting goals, as each entity struggles with the transition from a planned economy to a market-oriented economy in the Reform Era.

⁸ John Frankenstein and Bates Gill, "Current and Future Challenges Facing Chinese Defence Industries," *China Quarterly* No. 146, Oxford University Press June 1996, p. 398-403.

⁹ Richard J. Latham, "A Business Perspective," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.151-152.

¹⁰ The State Council defense industries began in the 1950's and are based on the Korean War-era Military Industry and Aviation Industry Commissions and on 41 of the 156 Soviet "key projects" that were designed for weapons production.

The most important management body of the CMIC is the Commission on Science, Technology and Industry for National Defense (COSTIND), which is the key link between the PLA, the State Council and the CMIC. The main function of COSTIND is to organize defense science and technology research, developing, testing, design finalizing and manufacturing of new weaponry, and the research and development of space technology. COSTIND is also responsible for overseeing the financial aspects of research and production sectors, supervising the export of defense products, managing commercial and military satellite launches, and monitoring cooperation between foreign countries and the CMIC. The current trend in the devolution of authority to profit-oriented and independent-minded provincial and local officials, however, has translated into an erosion of COSTIND's command over the allocation of resources and production.

The scope of the CMIC cannot be accurately measured, since many elements of the CMIC remain sensitive to the Chinese government. Estimates of the size and scope of the defense establishment's enterprises are also difficult to assess, however, most appraisals stand at between 15,000 to 20,000 enterprises, run by the PLA, the Ministry of Defense, and other defense-related organizations¹¹. The PLA admits to having 20,000 companies under its direct control, but outside estimates place the number considerably higher.^{12 13} Around sixty of the PLA's industrial plants are designated large enterprises (assets of over several hundred million yuan), out of a national total of about 3500 state-owned enterprises. An additional 166 are characterized as medium-sized enterprises.

The Structure & Management of the Military's Business Complex

PLA economic organizations started as units devoted to internal, self-supporting supply, distribution, and military logistics, but have expanded their operations to the

¹¹ Solomon M. Karmel, "The Chinese Military's Hunt for Profits," *Foreign Policy* Summer 1997, p.105.

¹² Former CMC Secretary-General Yang Babing said the military had more than twenty-thousand enterprises in 1992. See "Yang Babing Speaks at Family Planning Meeting," *Xinhua Domestic*, 2 Apr 92, in *Foreign Broadcast Information Service, Daily Report China*, in 8 Apr 92, p.41.

¹³ The number of enterprises estimated are often those of the entire defense establishment (or CMIC) vice only those owned and operated by the PLA, which is likely to be about 20,000. The CMIC is likely to operate 30,000 or more enterprises, but no accurate figures are available.

civilian sector. The impetus for this expansion is principally attributed to the shortfalls in government defense expenditures. The available data shows that China's allocation of resources in the 1980's favored economic development over defense funding. Therefore, the crowding out of the defense industry and under-funding of the military budget led to the PLA's need to initiate its own fund-raising activities.¹⁴ Considering in 1994 that the PLA had to find between 14.24-127.93 billion yuan¹⁵ over and above the stated defense budget, clearly explains the PLA's high-level of business-oriented motivation. This extra expenditure had to be supported by business revenue from PLA enterprises and highlights the urgent requirement for PLA business diversification. The army's expansion has been remarkably diverse and includes the integration of operations run from the top command organizations down to the seven military regions¹⁶, the twenty-four group armies, and subordinate local units.¹⁷

Overall military direction comes from the CMC through the General Logistics Department (GLD), while the Ministry of National Defense acts as a spokesman for PLA requirements within the State Council. While the centrally managed GLD has overall responsibility for overseeing the military's economic activities, due to the military budgeting shortfalls within the past decade, many of the military-complex's factories grew without uniform directives from the GLD. The extreme pace of economic development within the PLA has forced the GLD to undertake regular rectification campaigns to purge unhealthy business practices and periodically revamp the military business complex. These campaigns, however, are seen as short-term fixes and have not

¹⁴ The PLA's budget was markedly decreased during the 1980's to facilitate Deng's economic reform plans, however, decreases in personnel numbers also occurred, which may have translated into an initial budgetary gain. An overall military budget assessment is difficult, however, because budgetary subsidies are not easily accessed; the likelihood is that military spending was decreased to finance economic growth.

¹⁵ The *Renminbi* (the People's Currency) or *yuan* as it is commonly referred to currently trades at a rate of 8.2795 yuan per \$US dollar (2 Apr 98); however even in current terms this is a substantial military budgetary shortfall.

¹⁶ The seven military regions (MR) within the command structure of the PLA are: Beijing MR, Chengdu MR, Guangzhou MR, Jinan MR, Lanzhou MR, Nanjing MR, and Shenyang MR.

¹⁷ John Frankenstein, "China's Defense Industry Conversion," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.10.

been successful in mitigating many of the long-term problems found within PLA business enterprises.¹⁸

Although the GLD has general responsibility for oversight of the military-business complex, day-to-day administrative management is carried out by the Production and Management Department (PMD) under the GLD.¹⁹ These departments extend down to the provincial military districts and also to major operational units, such as group armies. Responsibilities of the PMDs are wide-ranging and include responsibility to design long-term PLA business development plans, inspect military enterprises, manage labor issues, oversee major production projects, and supervise all military-business financial accounts. Despite the structured nature of the managerial system overseeing the military enterprise system, the PMDs have not been able to keep pace with the phenomenal growth of the military-business sector. This is primarily attributed to the use of out-dated managerial techniques and the lack of a sufficient manpower base to monitor the proliferation of enterprises throughout the PLA's military structure.

Corporatization of the Military's Enterprises

Though PLA enterprises are young, the PLA has diversified its business activities well within the Chinese market and abroad. The majority of PLA firms began as small trading companies, diversifying into general trading companies and later incorporating investment and manufacturing businesses. Within the scope of a decade some of the PLA's franchises have developed into some of China's most successful business ventures. The speed of their growth and the scope of their diversification can be matched

¹⁸ The number of problems generated by the involvement of the PLA in business enterprises includes, but not exclusively, decreased levels of readiness, misappropriation of government property, widespread corruption within the officer corps, morale implications, and promotion irregularities not based on military performance.

¹⁹ Tai Ming Cheung, "The Chinese Army's New Marching Orders: Winning on the Economic Battlefield," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.182-185.

only by the Korean *chaebols*. Most of these conglomerates have been formed within the past few years and are organized at three distinct levels:²⁰

National-level Entities

National-level military conglomerates (NLMC) are among the largest and most profitable of all military-run enterprises. NLMCs are located at PLA general headquarters and the arms service department level. Most of these large entities were created in the mid-1980's and have continued to grow throughout the 1990's in power and business diversification.

General Staff Department (GSD):

The Poly Group Corporation - Poly (*Baoli* in Chinese) was first established in 1984 and was originally known as Poly Technologies. Set up as a foreign weapons trading arm of the GSD's Equipment Department, it operated publicly as a subsidiary of China International Trust and Investment Corporation (CITIC). In 1992, Poly emerged from the shadow to become an independent enterprise group with about one hundred subsidiaries under its control, including one or two listed companies on the Hong Kong stock market and trading firms in the United States and other countries. With assets of almost 8 billion yuan at the end of 1993, Poly has the largest capital base of all PLA enterprises and is also the PLA's top foreign trading entity.

China Huitong Corporation - Huitong was established in the early 1990's and took control of all GSD enterprises apart from those that belonged to Poly. It has over six hundred factories, mines, and farms and more than fifty technological research institutes. It engages in a wide range of business activities, from running hotels to tourist companies to foreign trade. Although it has considerably more factories and workers than Poly, Huitong is much less profitable because a sizable number of its enterprises are loss makers.

General Political Department (GPD):

Kaili Corporation - Kaili (also known as Carrie in English) was set up in 1984 as a trading company for the GPD, but has expanded into many other lines of business. Its core activities include property development, especially in coastal provinces, and the production of audio-visual products such as laser disks, and videos. Kaili has been extremely active overseas; it has a listed iron-ore mining company in Australia, a bank in the Cook Islands, and business operation in Hong Kong.

China Tiancheng Corporation - Tiancheng was originally established in the mid-1980's, but only became an enterprise group in the early 1990's. It is now responsible for the oversight of all the GPD's enterprises, excluding those that belong to Kaili. It is estimated to have capital assets of around 4 billion yuan, has seventeen subsidiaries scattered around the country, and engages in a diverse number of economic activities, such as real estate investment in Guangdong Province.

General Logistics Department (GLD):

China Xinxing Corporation - Xinxing includes nearly one hundred large and medium-sized enterprises employing 140,000 workers, as well as ten affiliated subsidiaries specializing in foreign trade, marketing, real estate development, chemicals, and advertising.

Other - Other holding companies held by the GLD include the San Ding Trading Corporation (which belongs to the GLD's PMD) and the GLD Trading Corporation.

People's Liberation Army Air Force (PLAAF):

China Lantian Industry Corporation - Lantian is the PLAAF's major commercial entity, which oversees most of the air force's business operations. The PLAAF has more than 430 factories, and mines, 160 air bases, and nearly 400 farms.

China United Airlines - The PLAAF's airline, which operates out of military air bases and uses air force transport assets and personnel.

²⁰ Ibid., p.186-191.

People's Liberation Army Navy (PLAN):

China Songhai Industrial and Commercial Corporation - The PLAN's principle conglomerate, which engages in commercial activities ranging from industrial production to foreign trade. The navy also has its own shipping fleet, which uses naval vessels and operates out of PLAN ports.

Second Artillery:

Shanhaidan Enterprise Group - Shanhaidan is best known for its pharmaceutical products.

China Tianlong Industrial and Commercial Corporation - A potential subsidiary also affiliated with the second artillery.

Commission for Science, Technology, and Industry for National Defense (COSTIND):

China Yuanwang Group - Yuanwang appears to be COSTIND's principal corporation at present.

China Xiaofeng - Xiaofeng was the first major COSTIND corporation set up in 1984, although the company is said to have cut some of its ties with COSTIND in the past few years.

China Galaxy - Galaxy is known to be affiliated with COSTIND.

China Xinshidai (New Era) Corporations - Xinshidai is a holding company that has kept a low-profile in recent years, although some of its provincial subsidiaries have been more active.

People's Armed Police (PAP):

China Anhua Development Corporation - Anhua was established several years ago by the PAP's Logistics Department. Anhua runs about seventy PAP enterprises and is authorized to engage in foreign trade.

China Jingan Equipment Import and Export Corporation - Before Anhua's establishment, the PAP conducted much of its business activities through Jingan, which is affiliated with the Ministry of Public Security.

The NLMCs are among the most profitable PLA commercial enterprises. They receive special privileges from the government and military authorities, including wide-ranging decision making autonomy, import-export trading rights, access to low-priced commodities, and generous tax and customs breaks.

Regional & Provincial-level Entities

Regional and provincial-level military conglomerates (RPLMC) provide commercial supervision of military enterprises, fostering horizontal linkages within China to enhance each PLA service element's competitive advantage within a region.

Beijing Military Region (BMR):

Huabei Jinhai Enterprise Corporation - A holding for the BMR, it has industrial, agricultural, mining, and other commercial operations in Beijing, Tianjin, Hebei, and Shanxi provinces, and the Inner Mongolia autonomous region.

Chengdu Military Region (CMR):

Southwest Great Wall Economic Development General Corporation - Southwest supervises the CMR. With many of its factories located in inaccessible parts of the four provinces and autonomous regions that the military covers, including Tibet, Sichuan, and Yunnan, Southwest is likely to be less profitable than its coastal counterparts.

Guangzhou Military Region (GMR):

Nanfang Industrial and Trading Corporation - Nanfang is probably the largest of the military region conglomerates. Its enterprises are located in five provinces, including Guangdong, Hainan, and Hubei. Its most profitable and dynamic firms are in Guangdong, in particular the Shenzhen, Zhuhai, and Shantou special economic zones and Hainan province. However, many of the inland provinces lose money. Nanfang was ranked as the 148th largest foreign trading corporation in 1993, with exports of US \$117 million.

Cuicun Enterprise United Group - Cuicun is managed by the GMR Logistics Department, which manages the military region's 500-plus industrial and agricultural production bases.

Jinan Military Region (JMR):

Shandong Dongyue Corporation - Dongyue manages the commercial operations within the JMR, which covers Shandong and Henan provinces. There are more than six hundred PLA-owned enterprises within the JMR, with fixed assets of 650 million yuan in 1994.

Lanzhou Military Region (LMR):

Northwest Industrial and Trading Corporation - Northwest runs the enterprises run by the LMR. Many of the region's military industrial plants located in Shaanxi province, especially Xi'an, where farms and agricultural production bases are situated in more remote areas.

Nanjing Military Region (NMR):

Huadong Industrial Corporation - Huadong oversees the enterprises within the NMR. Huadong was set up in 1992 to improve coordination and integration among Nanjing's military enterprises, which are scattered across five provinces and Shanghai.

Shenyang Military Region (SMR):

Dongbei Jingcheng Industrial and Commercial Corporation - Jingcheng is one of the largest regional conglomerates. It operates primarily in Liaoning, Jilin, and Heilongjian provinces and has one thousand mostly small enterprises, a work force of eighty thousand, and registered capital of 2 billion yuan in 1992.

Songliao Enterprise Group - Songliao specializes in vehicle production and repair.

Provincial Military Districts (e.g., Sichuan Military District):

Sichuan Bashu Enterprise Group - Bashu is an example of individual military district attempts to establish conglomerates in their regions. Bashu was set up in 1992 to assume supervision of Sichuan's military district commercial operations.

Unit-level Entities

The status of unit-level military enterprises remains in flux due the periodic exercise of rectification campaigns by the CMC. During the 1993 rectification campaign, units at and below division level were allowed to keep only two factories and were required to transfer control of their other enterprises to high-level authorities. However, this allocation appears to be largely politically driven with some units impacted more than others during particular rectification efforts by the center.

Most of the enterprises owned by division or lower-level units tend to be small ventures employing several dozens to several hundreds of workers, usually with family military personnel or demobilized soldiers. The nature of unit-oriented commercial activities is often constrained by the location and operational status of a particular unit. For example, deployable units are less able to establish themselves in business activities, since more time is spent on operational readiness. While other units have fewer opportunities to engage in entrepreneurial activity due to their posting location (i.e., the coastal regions in Southern China vice the inland areas of Xinjiang and Tibet).

Military-Business Operations, Profits, and Benefits

One of the widely held misperceptions is that PLA companies primarily engage in weapons trading, such as missile sales to Iran and Pakistan, weapons transactions with developing countries, and the purchase of advanced weapons technologies from the West. In reality, most PLA companies are only marginally involved in the defense-sales market; with most PLA businesses oriented towards making profits in the broader civilian market.²¹ Official statistics show that since 1987 the value of the military's civilian production has been greater than the value of its military production²². The reality is that most military enterprises aren't even licensed to participate in foreign export-import operations nor do the majority have access to the advanced technologies that foreign defense establishments are interested in purchasing.

Military-affiliated enterprises can be found in almost every sector of the Chinese economy, however, the economic focus of the military-business complex has not changed as much as it might appear. The military remains entrenched in many of its traditional areas of production, including agriculture (which make up 7-8 percent of total economic turnover of the PLA and 10 percent of the profits), industry (which makes up 55-60 percent of the PLA's business turnover and 40 percent of the total profits), and tertiary industries (which makes up about 25 percent of the PLA's turnover and as much as 50 percent of military-business complex profits²³). Heavy concentrations of military enterprises are found within the transportation, vehicle production, pharmaceutical production, hotel-tourism, property development, textile production, mining, and telecommunications industries.

²¹ Min Chen, "Market Competition and the Management of PLA Companies," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.212-213.

²² Solomon M. Karmel, "The Chinese Military's Hunt for Profits," *Foreign Policy* Summer 1997, p.105.

²³ Tai Ming Cheung, "The Chinese Army's New Marching Orders: Winning on the Economic Battlefield," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, , Lynne Rienner Publishers, 1998, p.191-192.

Declared profits from the military-business complex are roughly equivalent to between 10 and 15 percent of China's published defense budget. In 1992, for example, total profits from military-business operations were 5 billion yuan²⁴ and defense expenditures for the year were 37 billion yuan. A more realistic estimate for the PLA's annual commercial profits is about 10-15 billion yuan (US \$1.2-\$1.8 billion) on a turnover of between 50-75 billion yuan.²⁵ The income earned by PLA businesses has increased rapidly since the mid-1980's with annual turnover and profits growing at an average rate of 15 percent per annum. Military-run industry (much like the state-owned enterprises), however, has proven to be a losing business approach, which has absorbed many of the tertiary industry's high profit margins.

Revenue distribution is also an interesting phenomenon within the scope of the military-business complex. Military enterprises are allowed to keep between 20 and 40 percent of their profits for reinvestment and other uses, while the remaining funds go to regional and provincial military authorities (10 to 20 percent), the GLD (which receives the majority at between 40 and 60 percent) and the local PLA unit that owns the enterprise (which nets 10 to 20 percent).²⁶ The actual revenue that is distributed to the GLD and other PLA units is probably only 4-6 billion yuan. Although the PLA's involvement in business activities has been lucrative, it may not be the cash cow many outside observers perceive. Losses suffered by military authorities due to unreported business income could run into the billions of yuan, but the illegal retention of profits is a classic problem within the Chinese tax-reallocation system which remains a largely unresolved problem. Other PLA loss problems are also likely attributable to widespread inefficiency and quality control problems found within Chinese state run industry.

²⁴ 5 billion yuan in 1992 was equivalent to approximately US \$910 million at the official 1992 exchange rate.

²⁵ Tai Ming Cheung, "The Chinese Army's New Marching Orders: Winning on the Economic Battlefield," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.193-196

²⁶ Ibid., p.195-196.

The military-business complex is privy to a variety of benefits within China's economic structure. Favorable financing terms and the ability to freely use public resources are major advantages available to the PLA enterprises. The military is in the unique position to exploit telecommunications, technologically advance facilities, road, rail, and air transport for organizational or personal profit, and military sources admit that military maintained monopolies have begun to erode civil-military relations. The favorable terms of loans made to the military and other entities affiliated with the CMIC are easily obtained since there is little concern within the banking system of the PLA going bankrupt.²⁷

Negative Impacts of PLA Business Involvement

The explosive growth of the PLA's involvement in business activities created several types of problems, including corruption, smuggling, speculation, and the illegal use of military personnel and equipment for commercial purposes. These occurrences compelled the CMC to institute several correcting measures to combat the proliferation of unscrupulous activities throughout the ranks. These enforcement mechanisms have included:

- 1985 regulations passed to curb problems of confusing the responsibilities of the military with those of the PLA's enterprises (these were again instituted in 1988).²⁸
- The 10 Nos - a set of regulations issued by the CMC (1989).^{29 30}
- Implementation of additional regulations banning military personnel and units from speculating, in the foreign exchange, stock, and real estate markets (unspecified).
- Periodic review of military economic behavior (i.e. the 1993 rectification campaign).
- Issued CMC directive on "Opinions on Strengthening Management Over the Military's Finance and Economy" (1993).
- CMC issued directive banning units beneath the group army level from engaging in commercial activities.³¹

²⁷ Min Chen, "Market Competition and the Management of PLA Companies," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.212-213.

²⁸ June Teufel Dryer, "The New Officer Corps," China Quarterly No. 146, Oxford University Press June 1996, p.332.

²⁹ The 10 No's forbid: the use of vehicles or resources for speculation, profiteering, or smuggling; the lending, selling, or hiring out of military vehicle licenses, bank accounts, and blank invoices; participation in panic buying of goods at higher prices, illegally buy up goods, or profiteering and raising prices in any form; and the employment of military personnel by companies or engage in trade.

³⁰ Tai Ming Cheung, "The Chinese Army's New Marching Orders: Winning on the Economic Battlefield," Mixed Motives, Uncertain Outcomes: Defense Conversion in China, Lynne Rienner Publishers, 1998, p.183.

The rectification campaigns combined with the implementation of both these new regulations and an overhauled management system, has led to a substantial decrease in the number of military-enterprises. By the beginning of 1995, the total number of military enterprises in the coastal regions was cut by 40 percent. All service personnel were said to have withdrawn from business activities and more resources devoted to the traditional areas of sideline agriculture and production work. Enforcement of these regulations, however, has been sporadic and appears not to have halted the military pursuit of enterprising activities. The ability of military cadres to circumvent orders from Beijing has been facilitated by local interests and financial independence.

Not all of the PLA's business activities are legal.³² Military sponsorship has been traced to a number of karaoke bars and prostitution rings in China's major cities; real estate speculation is widespread; PLA entities hold major stakes in China's nascent securities markets; and smuggling is rampant throughout the military services. The continued reporting of a wide-variety of military infractions including the misuse of army registrations and advertising rights, the impersonation of officers for profit, piracy on the high seas, money-laundering, black-market peddling of military-produced or controlled products, and Mafia-type activities, indicates that the military continues to demonstrate an increasing inclination towards unethical activities for profit.

Conclusion

The Military-Business Complex continues to be burdened by many of the problems inherent in the Reform Era market system. Military enterprises face similar difficulties in obtaining capital for investment and many suffer from the plan-oriented shortcomings of the state-owned enterprises. The military, however, seems advantageously positioned to profit due to the current lack of controls within the Chinese economy. The PLA has demonstrated an adept capability at avoiding confrontation with

³¹David Shambaugh, "China's Military Transition: Politics, Professionalism, Procurement and Power Projection," China Quarterly No. 146, Oxford University Press June 1996, p.277.

the central government and cashing in on eluding the limited number of state controls present in China's evolutionary market. For the military-business to remain successful, however, a number of changes will have to be made to adapt its enterprises more readily to the overall Chinese system including more emphasis on efficiency vice cronyism, adoption of streamlined management techniques in the military's financial accountability network, and the cultivation of international exchange and cooperation within technological areas.

Indeed if military-controlled profits and taxes continue to grow at the current magnitude they are likely to become the military's most important peacetime priority. This shift in military focus has a limitless number of potential outcomes, which may yield several negative consequences for China's future economic and political reforms. A number of these outcomes include business partnerships that create conflicts of interest within the PLA's leadership making the military less able to steadfastly defend China's sovereign strategic priorities; a sharp increase in corrupt military activities, which will further erode the legitimacy of the remaining socialist-regime, sparking a resurgence of public discontent (as seen during the 1989 Tiananmen crisis); and the increasing potential that as the military continues to compete for profits it will become more and more apt to behave contrary to international and domestic norms (i.e., the Nuclear Non-Proliferation Treaty, Missile Control Regime, etc.) by selling critical technologies to rogue states looking for specific boosts to weapons programs for large short-term profits.

The question of whether or not the PLA should remain engaged in economic activities in the short-term is a matter of survival and remains unquestionably yes. The decision to push the Red Army into a hunt for commercial profits probably helped China to avoid the short-term budgetary crises experienced by Russia and other former-Communist states in the post-Cold War era³², but in the long-term the government will have to separate the PLA from its enterprises to insure the stability it desires within a

³² Soloman M. Karmel, "The Chinese Military's Hunt for Profits," Foreign Policy Summer 1997, p.112.

³³ Soloman M. Karmel, "The Chinese Military's Hunt for Profits," Foreign Policy Summer 1997, p.105.

centrally managed political hierarchy. Concerns about discipline in the armed forces will remain a touchy political issue. Without the central government capable of paying the PLA to maintain a non-business relationship, the problems affiliated with corruption will remain. Although periodic crackdowns are likely to continue; enforcement of CMC directives outside of Beijing will remain difficult in the absence of a properly supported policing agency. Commercialization is obviously antithetical to the military corporate ethos and *esprit de corps*, but a long-term remedy to this apparent conflict of interest is unlikely in the near term economic environment.³⁴

³⁴ David Shambaugh, "China's Military Transition: Politics, Professionalism, Procurement and Power Projection," China Quarterly No. 146, Oxford University Press June 1996, p.278.